

## Message Text

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PAGE 01 MEXICO 21221 01 OF 02 220104Z

ACTION ARA-14

INFO OCT-01 ISO-00 AID-05 CIAE-00 COME-00 EB-08 FRB-03

INR-07 NSAE-00 USIA-06 XMB-02 OPIC-03 SP-02

LAB-04 SIL-01 OMB-01 NSC-05 SS-15 STR-05 CEA-01

AGRE-00 DOE-12 SOE-01 HEW-04 OES-07 /107 W

-----120544 220129Z /72

R 212342Z DEC 77

FM AMEMBASSY MEXICO

TO SECSTATE WASHDC 7167

INFO TREASURY WASHDC

LIMITED OFFICIAL USE SECTION 01 OF 02 MEXICO 21221

EO 11652: N/A

TAGS: EFIN, MX

SUBJECT: COMMENT ON 1978 PUBLIC SECTOR BUDGET

REF: A) MEXICO 20995, B) MEXICO 21088

1. SUMMARY. THE STRATEGY BEHIND 1978 PUBLIC SECTOR BUDGET IS TO INCREASE THE ECONOMIC GROWTH RATE BY INCREASING PUBLIC SECTOR INVESTMENT. AT THE SAME TIME, THE GOM HOPES TO REDUCE THE RATE OF INFLATION AS MEASURED BY THE CONSUMER PRICE INDEX TO ROUGHLY 1 A MONTH THROUGH 1978. AGRICULTURE, ENERGY AND EDUCATION ACCOUNT FOR MOST OF THE SPENDING INCREASE. NO NEW SIGNIFICANT TAX MEASURES WERE INTRODUCED. WHILE MORE INFORMATION THAN USUAL IS PROVIDED IN THE 1978 BUDGET PRESENTATION, IT IS DIFFICULT TO MAKE YEAR TO YEAR COMPARISONS FOR SPECIFIC PROGRAMS.

2. 1978 PUBLIC SECTOR EXPENDITURES ARE TO INCREASE 23.6 OVER ESTIMATED 1977 EXPENDITURES. CAPITAL OUTLAYS ARE TO BE UP 31.2 IN CURRENT PRICES AND 14.2 IN REAL TERMS, IMPLYING A PRICE DEFLATOR OF APPROXIMATELY 15.

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PAGE 02 MEXICO 21221 01 OF 02 220104Z

CURRENT SPENDING (EX-INTEREST) IS TO INCREASE 16.6 IN CURRENT PRICES. SALARIES ARE THE MAIN ELEMENT IN THIS CATEGORY AND THE BUDGET DOES NOT STATE WHAT INCREASE WAS PROGRAMMED, MAKING IT IMPOSSIBLE TO ESTIMATE THE PROGRAMMED REAL INCREASE. WE WOULD SUSPECT THAT THIS WOULD BE LESS THAN 15, THEREBY ALLOWING FOR SOME INCREASE IN REAL TERMS, AND SOME INCREASE IN PUBLIC SECTOR

EMPLOYMENT. INTEREST AND AMORTIZATION EXPENSES ARE TO INCREASE 33.4 BASED ON NO CHANGE IN THE EXCHANGE RATE. TRANSFERS TO LOCAL GOVERNMENTS OF CERTAIN TAX REVENUES ARE PROGRAMMED TO INCREASE 16.8.

3. OF THE INCREASE IN INVESTMENT EXPENDITURES, 73.2 IS FOR ENERGY AND 15.9 FOR FOODSTUFFS. AS REGARDS CURRENT SPENDING, 43.5 OF THE TOTAL INCREASE IS FOR EDUCATION, HEALTH AND SOCIAL SECURITY; 33.4 OF THE TOTAL INCREASE IS RELATED TO ENERGY AND FOODSTUFFS. THE TABLE IN PARA 5 OF REF B PROVIDES INFORMATION ON SPENDING FOR VARIOUS SECTORS AND THE INCREASES. WHILE A CERTAIN AMOUNT OF INFORMATION ON THE BREAKDOWN OF SPENDING WITHIN THESE SECTORS WAS PUBLISHED, THERE ARE NO YEAR TO YEAR COMPARISONS FOR MOST PROGRAMS, THOUGH WE SHOULD BE ABLE TO GET SOME MORE INFORMATION IN JANUARY. FOR EXAMPLE, UNDER AGRICULTURE, VARIOUS PROGRAMS AND TARGETS ARE LISTED; I.E., SMALL IRRIGATION WORKS WILL BENEFIT 45,000 HECTARES, AND LARGE IRRIGATION PROJECTS WILL BENEFIT 100,000 HECTARES. CREDIT PROGRAMS IN THE BUDGET WILL AMOUNT TO 12.6 BILLION PESOS, MOSTLY THROUGH THE RURAL BANK. THESE MAY BE SUBSIDY PAYMENTS AS NATIONAL CREDIT INSTITUTIONS ARE NOT INCLUDED IN THE BUDGET. PIDER IS TO GET 2.7 BILLION PESOS.

4. PEMEX ACCOUNTS FOR 58.5 OF THE INDUSTRIAL SECTOR'S LIMITED OFFICIAL USE

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PAGE 03 MEXICO 21221 01 OF 02 220104Z

BUDGET. AMONG THE 1978 TARGETS ARE AVERAGE DAILY PRODUCTION OF CRUDE OF 1.3 MILLION BARRELS OF WHICH 428,000 IS TO BE EXPORTED. THE PEMEX INVESTMENT BUDGET OF \$3 BILLION INCLUDES EXPENDITURES FOR THE GAS PIPELINE.

5. ON THE REVENUE SIDE, THE GOM HAS OPTED FOR NO SIGNIFICANT REFORMS. WE UNDERSTAND A VALUE-ADDED TAX WAS UNDER SERIOUS CONSIDERATION, BUT DROPPED, APPARENTLY BECAUSE OF BUSINESS OPPOSITION. THE SUBSTANTIAL REVENUE INCREASE IS TO COME FROM BETTER ADMINISTRATION AND INCREASED ECONOMIC ACTIVITY. PEMEX WILL MAKE A MAJOR CONTRIBUTION. THEIR DAILY TAX PAYMENT IS BEING RAISED FROM 22 MILLION TO 27 MILLION PESOS. THE TAX ON GROSS PEMEX REVENUES WAS RAISED FROM 16 TO 17. IN THE PAST, PEMEX HAS NOT BEEN A MODEL TAXPAYER. EXPORT RECEIPTS FROM NATURAL GAS REVENUES ARE TO BE TAXED AT A 50 RATE, WHICH IS THE RATE ON CRUDE OIL EXPORT RECEIPTS.

6. WHILE NOT RAISING TAXES ON BUSINESS, FINANCE SECRETARY IBARRA PROMISED THAT FISCAL INCENTIVES WOULD BE INTRODUCED TO STIMULATE EMPLOYMENT, INVESTMENT, EXPORTS, THE "EFFICIENT" SUBSTITUTION FOR IMPORTS, AND DECENTRALIZATION.

PRESUMABLY THESE, PLUS A GREATER PESO CREDIT AVAILABILITY, ARE TO CONSTITUTE THE GOM'S EFFORT TO BOOST PRIVATE INVESTMENT, AN ECONOMIC POLICY OBJECTIVE THAT WAS MENTIONED SEVERAL TIMES. HE ALSO INDICATED THAT MAJOR TAX REFORMS WOULD BE STUDIED DURING THE PRESENT YEAR.

7. THE NET NEW FINANCING REQUIREMENT IN THE PUBLIC SECTOR DEFICIT IS 94.5 BILLION PESOS. OF THIS, 50 BILLION IS TO COME FROM DOMESTIC SOURCES AND 44.5 BILLION FROM EXTERNAL SOURCES. THE PROPOSED REVENUE LAW PROVIDES THAT ADDITIONAL NET NEW BORROWING CAN BE UNDERTAKEN, IF NEEDED.

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PAGE 01 MEXICO 21221 02 OF 02 220011Z  
ACTION ARA-14

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TO SECSTATE WASHDC 7168  
INFO TREASURY WASHDC

LIMITED OFFICIAL USE SECTION 02 OF 02 MEXICO 21221

THE \$3 BILLION CEILING ON NET NEW EXTERNAL PUBLIC SECTOR BORROWING CAN BE RECONCILED TO THE ABOVE FIGURE BY ASSUMING THAT PART OF THIS BORROWING WOULD BE USED TO INCREASE RESERVES AND PART WOULD BE DRAWN DOWN BY NATIONAL CREDIT INSTITUTIONS SUCH AS NAFINSA AND THE RURAL BANK TO FUND LOANS TO NON-PUBLIC SECTOR ENTITIES. THESE CREDIT INSTITUTIONS ARE NOT INCLUDED IN THE BUDGET.

8. IT SHOULD BE NOTED THAT THE BUDGET AS DESCRIBED IS THE EXECUTIVE'S PROPOSAL TO CONGRESS. THERE MAY BE SOME MINOR CHANGES IN THE VERSION THAT IS PASSED, THOUGH THE TIME ALLOTTED CONGRESS FOR DISCUSSION IS QUITE SHORT AS THE BUDGET MUST BE APPROVED BY JANUARY 1.

9. IN EVALUATING THE BUDGET WE WANT TO EXPRESS A NOTE OF CAUTION. WHILE THE BUDGET APPEARS RELATIVELY CONSERVATIVE, WE QUESTION THE GOM'S ABILITY TO HOLD SPENDING WITHIN THE

PROGRAMMED AMOUNT. EVEN THIS YEAR, WHEN SPENDING WAS  
RETARDED BY THE GOVERNMENT REORGANIZATION, THEY APPEAR TO  
HAVE OVERSPENT THE BUDGET BY ABOUT 9. THE GOVERNMENT  
RETAINS CONSIDERABLE FLEXIBILITY IN MAKING CHANGES  
DURING THE FISCAL YEAR. WE ALSO QUESTION THE GROWTH  
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PAGE 02 MEXICO 21221 02 OF 02 220011Z

TARGET WHICH UNDERLIES THE REVENUE ESTIMATE. THEY MAY  
BE HOPING TO GET MORE TAX REVENUE FROM PEMEX THAN WILL  
MATERIALIZE. LUCEY

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## Message Attributes

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